Recommendations on Conflict-of-Interest Disclosure
for
FPPC Task Force

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Background

We have been assigned to review three areas concerning conflict-of-interest disclosure under the Political Reform Act ("PRA"). These areas are discussed below.

The PRA requires numerous state and local public officials to file periodic Statements of Economic Interests (FPPC Form 700 and accompanying Schedules A-1 through E) disclosing specified financial interests of the official. The financial interests are organized into investments, real property, sources of income, sources of gifts, and positions held with for-profit businesses (such as director, officer, employee; known as "business positions"). The PRA also prohibits a public official from making, participating in, or using her official position to influence a governmental decision in which she has a financial interest.

Requiring public officials to publicly disclose their financial interests serves two general purposes under the PRA: First, by requiring the periodic disclosure of these interests, it reinforces a public official's knowledge of the types of interests in which she may have a conflict-of interest. Second, by making the disclosure public, it allows the public, the press and law enforcement agencies to monitor whether a public official may have a conflict of interest in a specific governmental decision.

Disclosure in most of these reporting categories is not required until the public official's financial interest reaches a statutorily-set dollar threshold. These dollar thresholds and other financial disclosure issues, and our recommendations, are discussed below.

1. Conflict of Interest Disclosure Thresholds

Below is a list of the financial disclosure thresholds for a public official, and the amount at which that interest created a conflict-of-interest issue for the official, as set forth in both the 1974 and current versions of the PRA. The current thresholds were placed in the PRA in 2000.

	Financial Interest Disclosure Threshold	Conflict-of-Interest Threshold
Investment:	1974 PRA - $10,000	1974 PRA - $1,000
	Current PRA - $2,000	Current PRA - $2,000
Real Property:	1974 PRA - $10,000	1974 PRA - $1,000
	Current PRA - $2,000	Current PRA - $2,000

	Financial Disclosure Threshold	Conflict-of-Interest Threshold
Income:	1974 PRA - $250 Current PRA - $500	1974 PRA - $250 Current PRA - $500
Gift:	1974 PRA - $25 Current PRA - $50	1974 PRA - $250 Current PRA - $420 (adjusts with the gift limit)
	Business Position – Director, officer, partner, trustee, employee, position of management in a business entity (Same in 1974 and current PRA)	Holding any of these positions (Same in 1974 and current PRA)

As is evident, the thresholds for both disclosure and conflict of interest on income and gifts have doubled since 1974 and the criteria for business positions has remained the same.

However, in the 1980s, the Legislature decreased the disclosure thresholds for investments and real property from the $10,000 amount in 1974 to $1,000 and, in 2000, increased the threshold to the current amount of $2,000. The $1,000, and later $2,000, disclosure thresholds matched the conflict-of-interest thresholds for those financial interests. By decreasing the disclosure amounts on these financial interests to the same threshold for conflict-of-interest, the Legislature apparently felt it would be easier to monitor an official's possible conflicts of interest if the disclosure threshold was closer in value to the conflict-of-interest threshold.

The main issue we have considered here is whether these threshold disclosure and conflict-of-interest amounts remain accurate indicators of when a public official may be influenced by personal gain or loss when her financial interests are affected by a governmental decision in which she participates. In considering this issue, we have made two inquiries. First, what is the current dollar amount of each threshold if adjusted for inflation from its amount in 1974? Second, does the current threshold amount for each category, the threshold amount as adjusted for inflation, or some other dollar amount, in our view, adequately represent a point at which a reasonable person might expect a public official to be influenced when participating in governmental decisions?

Adjustments for Inflation

Based on the Consumer Price Index, what was $1 in 1974 is now worth about 4.5 times that, or $4.50. Based on this, set forth below is a rough estimate of what the current threshold amounts would be when adjusted from 1974.

Investment and Real Property (Disclosure and Conflicts):	$4,500
Income (Disclosure and Conflicts):	$1,125

Gift Disclosure:	$113
Gift Conflicts:	$1,125

Consideration of an Appropriate Threshold for Each Disclosure/Conflict-of-Interest Category

Investments. We think the threshold disclosure and conflict-of-interest levels for investments in businesses in which an official owns less than a 10% interest should be adjusted beyond even the $4,500 CPI-adjusted value currently in the PRA. The Dow Jones Industrial Average for stocks was below 1000 for most of 1974, the year the voters passed the PRA. On November 9, 2010, that figure was 11,400, or more than ten times the average in 1974. Because of this and other factors discussed below, we think that an appropriate disclosure and conflict-of-interest threshold for investments in a business in which the official owns less than a 10% interest would be $10,000. We think this is reasonable for several reasons. This threshold does not apply to any direct financial gain or loss to the public official. It merely reflects a point at which the official must disclose the interest in the business and thereafter determine if a governmental decision in which she is participating materially affects the business itself. While the effect of the decision could result in an increase or decrease in the value of the official's investment in the business, that is not a consideration under this part of the conflict-of-interest analysis. That issue would be analyzed separately from this by looking at whether the decision's effect on official's personal finances reaches a "material" threshold determined under other FPPC regulations, which could be amended to address this issue if the PRA is amended to reflect the recommended increase in conflicts of interest for investment interests. Also, limiting the increased threshold to only those investments in which the official owns less than a 10% interest permits a separate analysis on the issue of whether the official has a conflict of interest when her investment interest in the business is 10% or more.

For example, if an official owned $9,000 in a green energy company's stock (but owned less than 10% of the company) and was voting on a decision that would financially benefit the company, she could do so as long as the financial effect of the decision did not have a material effect, as determined in the Commission's regulations, on the official's personal wealth. But if the official owned $10,000 of stock in the company, regardless of the financial effect on her personal wealth, she would have a conflict of interest if the financial effect of the decision on the company itself was material.

Real Property. Likewise, we think the thresholds for disclosure and conflict of interest for real property should be adjusted to $10,000. Given the drastic rise in property values in the last 35 years, the overwhelming number of public officials in California who own real property are likely to have an investment interest in the property far in excess of the $1,000 disclosure and conflict-of –interest thresholds for real property that was in effect in the 1980s or even the $2,000 threshold implemented in 2000. Also, if the Commission is concerned about an official who owns a real property interest of less than $10,000 may be able to participate in governmental decisions that will increase the value of that interest to over $10,000, it has the power by regulation to consider effects on the personal wealth of the official. Therefore, as with investments, we think increasing the thresholds for disclosure and conflict of interest for real property interests to $10,000.

Income. We also recommend that the $500 disclosure and conflict-of-interest threshold for sources of income remain the same. We note that the PRA already requires a public official to disclose her position as an employee of a business entity and, regardless of salary, the official would have a possible conflict of interest if she participated in a decision affecting that entity. Keeping the income threshold at $500 would continue to require disclosure of other sources of income, including non-profits or persons for whom the official might do work on an ad hoc basis. In this context, we think the $500 threshold figure is still significant enough to cause a reasonable person to conclude that an official could be influenced in decisions affecting sources of this income.

Gift Disclosure. We recommend that the $50 gift reporting threshold remain the same. In our view, a $50 gift is still considered a significant amount and requiring disclosure at this dollar threshold assists in tracking potentially several gifts from the same source during a calendar year.

Gift Conflicts. The PRA currently sets the conflict-of-interest threshold for gifts from the same source at the same level as the gift limit in effect at the time the official participates in the governmental decision affecting the source. The gift limit adjusts with inflation and is re-calculated at the beginning of each odd-numbered year. The current gift limit is $420, meaning this is the current threshold for conflicts of interests on decisions affecting sources of gifts.

We have two observations on the $420 threshold. First, unless there is a statutory change, it is possible that sometime in the next decade the conflict-of-interest threshold for sources of gifts will be higher than that for sources of income. We think this would be an absurd development. Secondly, we think even the current $420 threshold is too high. The PRA exempts gifts from an official's family members and FPPC regulations add additional exceptions to account for ordinary social intercourse such as entertainment in one's home and presents exchanged between friends on occasions such as birthdays and holidays. This means that a public official can now receive one or more gifts totaling to a value of up to $419.99 in a calendar year from a person appearing directly before them on a governmental decision and not have a conflict of interest. We think that a reasonable person would find it hard to believe that gifts in this amount from a total stranger who also happens to have business before the official do not influence the official's decision. We therefore believe that the conflict-of-interest threshold for gifts should be significantly lowered.

On this last point, we note that there has been a recent trend in some governmental agencies to prohibit their employees from taking any gifts, or in some cases, gifts from persons who have business before the agency. Several legislators and other public officials have such a policy. Also, the League of Cities, in its sample gift policy for its members, proposes either an outright ban on city officials taking gifts or, in the alternative, a ban on taking gifts from persons having business before the city.

2. Consideration of Simplifying Schedule A-2 of the Statement of Economic Interests

Schedule A-2, which is an attachment to the Statement of Economic Interests, requires public officials to disclose their financial interests in business entities and trusts in which they hold an interest of 10% or more or in which they hold a "business position." Based on statutory provisions, the official is required, among other things, to disclose on the form the name of the entity and her position with the entity (e.g., owner, employee, director, beneficiary of the trust), check a box with a specified dollar range indicating that the value of her interest falls within that range, check a box indicating within a range any income she receives from the entity, report the names of any sources of income to the entity from whom her pro rata share is $10,000 or more, and disclose any investments or real property held by the entity if her pro rata share reaches the threshold disclosure amount of $2,000.

We have examined the form and, although it can require an official to provide a significant amount of information, we do not find the form overly complicated or the information sought unreasonable. The form could perhaps be simplified by reducing the number of ranges from which the official has to select to report information, but we think a reasonable person would find the current ranges helpful in determining the level of the official's financial interest in a person who may appear before the official. For instance, there may be a much higher risk of a conflict of interest, and therefore more public scrutiny of an official's governmental decision, if the official reports she has an ownership interest in real property held by the entity valued at $100,000 to $1,000,000 than if she reports an interest worth $2,000 to $10,000.

We note, however, one bit of information that is required by statute to be reported on Schedule A-2, that, for privacy reasons should not have to be disclosed on that form. The PRA requires that the home address of an official be reported if the official maintains a business at her home, and this information appears on Schedule A-2. However, if an official is not maintaining a business at her home, the PRA does not require her to report her real property interest in the home at all (although she could still have a conflict of interest if she participates in a governmental decision affecting the home's value). We think the same privacy rationale should apply even if the official maintains a business at her home. Therefore, we think it reasonable that the PRA be amended to omit the requirement that an official provide the address of her home on Schedule A-2 merely because she maintains a business at the home.

3. Consideration of Modifying Applicable Statutory Definitions Relating to the Term "Investment" to Conform with Investment Forms not Contemplated in the Original Political Reform Act

As noted above, public officials who file Statements of Economic Interests under the PRA are required to report their investments. The term "investment" is defined in Government Code Section 82034. The definition is quite broad and, in our view, still adequately captures the myriad types of investment vehicles that have arisen since the PRA was passed in 1974.

However, there is a widely acknowledged problem that the exceptions stated in the definition are not flexible enough to allow the exclusion of many types of investment vehicles where an official has no way to know, or it is extremely burdensome to discern, exactly what companies or industries she is invested in. For example, the definition excludes disclosure of an "interest in a diversified mutual fund registered with the Securities and Exchange Commission under the

Investment Company Act of 1940." We assume an investment in a mutual fund is excluded from disclosure and conflicts of interest because a mutual fund invests in many different companies and the companies in the portfolio can change daily. Therefore, it makes sense that an official would not have to disclose, or have a conflict of interest relating to, this investment because she does not know at any given time what companies are in the mutual fund and thus cannot determine whether a governmental decision in which she participates will have a financial effect on those companies.

We do not pretend to have detailed knowledge of the current types of investment vehicles available to investors, but it is widely accepted that the types have significantly proliferated since 1974. And we assume there are now many types that are similar to mutual funds in that an official would not be aware of exactly what she owns at any given time.

On this basis, we believe that, rather than try to define all of these types of investments, that the Legislature instead amend the PRA's definition of "investment" in Government Code Section 82034 by stating, based on the rationale for excepting mutual fund investments, general criteria for the types of investments that do not have to be disclosed and do not create a conflict of interest. Furthermore, the amendment should authorize the FPPC to adopt regulations specifying the types of investments that fit these criteria.

Recommendations

Based on the foregoing discussion, we make the following recommendations:

Recommendation No. 1 - Amend the PRA to adjust the disclosure and conflict-of-interest thresholds for an investment to the $10,000 level, or at any level if the public official owns an interest of 10% or more in a business entity.

Recommendation No. 2 – Amend the PRA to adjust the disclosure and conflict-of-interest thresholds for an interest in real property to the $10,000 level, or at any level if the public official owns an interest of 10% or more in real property.

Recommendation No. 3 - Maintain the PRA's current $50 disclosure threshold for gifts, but amend the PRA to set the conflict-of-interest threshold for gifts at $250.

Recommendation No. 4 – Amend the PRA to establish the gift limit at $250 per source per calendar year, without biennial cost-of-living adjustments.

Recommendation No. 5 - Amend the PRA (and Schedule A-2 of the Statement of Economic Interests) to allow an official to omit disclosure of her home address for a business maintained at her home.

Recommendation No. 6 - Amend the PRA's definition of "investment" (in Government Code Section 82034) to permit the FPPC, by regulation, to exclude from disclosure specified investments in which the official does not know, or cannot discern without difficulty, the specific business entities or industries in which she is invested.